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BEFORE THE ARIZONA CORPORATION

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AZ CORP COMMISSION
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JEFF HATCH-MILLER, Chairman
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KRISTIN K. MAYES

IN THE MATTER OF THE
APPLICATION OF PERKINS
MOUNTAIN WATER COMPANY
FOR A CERTIFICATE OF
CONVENIENCE AND NECESSITY
IN MOHAVE COUNTY

DOCKET NO. W-20380A-05-0490

DOCKET NO. SW-20379A-05-0489

IN THE MATTER OF THE
APPLICATION OF PERKINS
MOUNTAIN UTILITY COMPANY
FOR A CERTIFICATE OF
CONVENIENCE AND NECESSITY
IN MOHAVE COUNTY

**RESPONSE TO STAFF'S MOTION
TO COMPEL AND REQUEST FOR A
PROTECTIVE ORDER**

(Oral Argument Requested)

Pursuant to Arizona Rule of Civil Procedure 26(c), Perkins Mountain Water Company and Perkins Mountain Utilities Company ("Perkins" or the "Applicants") hereby file this Response to Staff's Motion to Compel and Request for a Protective Order to prevent disclosure of highly confidential tax returns.

On July 7, 2005, Perkins filed an Application for a Certificate of Convenience and Necessity ("CC&N") (the "Application") to provide water and wastewater service to two master-planned communities in Mohave County, Arizona—Golden Valley Ranch ("Golden Valley Ranch") and the Villages at White Hills ("White Hills"). Master plans for both communities have been approved by Mohave County, subject to the requirement that the developer, Rhodes Homes Arizona, LLC, demonstrate the adequacy of the water supply. An evidentiary hearing was held on December 5, 2005, and the Administrative Law Judge issued her Recommended Opinion and Order ("ROO") on January 31, 2006, recommending approval of the Application with conditions. Subsequently, on February

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1 10, 2006, the Company filed in Docket a Letter of Water Adequacy from the Arizona
2 Department of Water Resources (“ADWR”) to the landowner reporting ADWR's
3 determination that there is an adequate water supply of 9,000 acre-feet of groundwater
4 physically available for Golden Valley Ranch. The ROO was scheduled for consideration
5 at the February 14, 2006, Open Meeting, but the matter was pulled from the agenda by the
6 Company prior to the Open Meeting. A Procedural Conference was held on March 17,
7 2006, to address the need to supplement the record regarding water adequacy for Golden
8 Valley Ranch and White Hills. On March 31, 2006, the Company filed an amendment to
9 the Application modifying the service area requested for the CC&N. Commission Staff
10 filed its First Set of Data Requests in this matter on the same day.

11 Staff now seeks to compel production of the federal and state tax returns for the
12 years 2003, 2004 and 2005 for the Applicants and five affiliated companies: Sagebrush
13 Enterprises, Inc., Sedora Holdings, LLC, Desert Community, Inc., American Land
14 Management, LLC, and Rhodes Homes Arizona, LLC (Staff BNC 1.13). Staff also
15 requests the federal and state income tax returns for Mr. Jim Rhodes for the years 2003,
16 2004 and 2005 when completed (Staff BNC 1.25).

17 Staff's Motion to Compel should be denied because: (i) Staff has failed to meet the
18 higher standard associated with a request for the production of tax returns when it failed to
19 demonstrate a compelling need for the information and when it failed to use less intrusive
20 means to obtain the information Staff is seeking; (ii) the request for the tax returns is moot
21 given the change in the ownership of Perkins as described below; and (iii) there exists a
22 need to protect non-parties from improper disclosure of confidential information.

23 Accordingly, Perkins requests that the Commission grant its request for a protective order.

24 **I. STAFF FAILED TO MEET THE HIGHER STANDARD ASSOCIATED**
25 **WITH A REQUEST FOR THE PRODUCTION OF TAX RETURNS.**

26 Staff has made an unsupported assertion that the tax returns are relevant and gives
27 but one reason for its request; verification that the owner of the utilities has the “financial
28 ability to adequately fund the operations of these potential public service companies.” A

1 court may only order the production of tax returns if they are relevant and when there is a
2 compelling need for them because the information sought is not otherwise available.
3 *Nicholas T. Aliotti v. The Vessel Senor*, No. C-03-0102 CW (EMC), 217 F.R.D. 496, 497
4 (N.D. Ca. Sept. 2, 2003); *see also Gattegno v PriceWaterhouseCoopers, LLP* 205 F.R.D.
5 70, 71-72 (D.Conn. 2001); *Fort Washington Resources, Inc. v Tannen*, 153 F.R.D. 78, 80
6 (E.D. Pa. 1994); *Terwilliger v York Int'l Corp.*, 176 F.R.D. 214, 216-17 (W.D.Va. 1997);
7 *Flores v. Albertson, Inc.* 2002 WL 1163623 at 3 (C.D.Ca. 2002).

8 The Ninth Circuit recognizes that “a public policy against unnecessary public
9 disclosure [of tax returns] arises from the need, if the tax laws are to function properly, to
10 encourage taxpayers to file complete and accurate returns.” *Aliotti* at 497. Furthermore, if
11 the Applicants are ordered to provide the tax returns to Staff, any information gleaned
12 from the returns would be inadmissible due to federal statute prohibiting such disclosure
13 by officers or employees of any state. *See* 26 USCS §6103. Tax returns and return
14 information shall be confidential, except as specifically authorized, such as law
15 enforcement activities, none of which are relevant here. *Id.*

16 Accordingly, Commission Staff has failed to meet this heightened standard
17 associated with a request for tax returns. The Applicants move the Commission for an
18 order pursuant to Ariz. R. Civ. P. 26(c) to prevent Commission Staff from seeking tax
19 return information about the Applicants, its five affiliated entities noted above, and the tax
20 returns of Mr. Jim Rhodes personally.

21 **A. THE INFORMATION SOUGHT BY COMMISSION STAFF IS IRRELEVANT TO**
22 **THE COMMISSION’S DUTY IN THIS CASE.**

23 In light of the serious damage arising from the disclosure of private and
24 confidential information, the Commission should issue a protective order if it determines
25 that “the potential harm to a party from whom discovery is sought outweighs the
26 importance of the information to the party seeking that information.” *Murata Mftg. Co. v.*
27 *Be! Fuse Inc.*, No. 03-C-2934, 2004 U.S. Dist. LEXIS 9771, *16 (N.D. Ill. May 25, 2004)
28 (citing cases regarding customer information); *see also, Premium Service Corp. v. The*

1 *Sperry & Hutchinson Co.*, 511 F.2d 225, 229 (9th Cir. 1975) (plaintiff's need for
2 discovery did not outweigh the burden and invasion of privacy to witnesses, "especially
3 since they were not parties to the suit"). Commission Staff must demonstrate that they
4 have a compelling need for confidential information. On the contrary, Staff has not cited
5 any authority or demonstrated any reason that would entitle them to obtain this
6 information. Commission Staff has not alleged any claim of fraud or any other type of
7 intentional misconduct in this case. This request is the worst sort of fishing expedition.

8 **B. LESS INTRUSIVE MEANS EXIST BY WHICH STAFF CAN OBTAIN THE**
9 **NEEDED INFORMATION OR ASSURANCES.**

10 Applicants are seeking to become public service corporations to provide water and
11 wastewater services to a proposed service area located in Mohave County. Companies
12 affiliated with the Applicants have *not* applied to provide utility service anywhere in
13 Arizona. The affiliates have no involvement in this case, and there has been no showing
14 that this information would be relevant to the granting of a CC&N to the Applicants in
15 this case.

16 This type of questioning exceeds the scope of this Commission's authority.
17 Allowing the public to obtain confidential tax information about privately held entities
18 would breach the highly confidential nature of business planning for closely held
19 companies, and the private financial matters and personal estate planning of private
20 individuals. To our knowledge and belief, this information has never been requested of
21 any applicant for a CC&N before this Commission.

22 As is standard practice at the Commission, attempts were made by the
23 Applicants to enter into a protective agreement with Commission Staff regarding
24 discovery. Staff's counsel took the highly unusual position of rejecting any type of
25 protective agreement.

26 Through discussions with Staff counsel, it was determined what information Staff
27 was attempting to elicit from the tax returns. Staff relayed five items of concern: 1)
28 current ownership of the entities - limited to Sagebrush, Sedora Holdings, Rhodes Homes

1 Arizona, Perkins Mountain Companies, American Land Management, Desert
2 Communities and the Rhodes Companies, LLC; 2) ownership percentages; 3) profitability
3 of entities; 4) whether Mr. Rhodes filed and paid his income taxes and 5) whether Mr.
4 Rhodes has adequate means of providing capital for the utilities.

5 The Applicants have submitted alternative documents to Staff that provide the
6 information necessary to address their concerns. Current ownership and percentages was
7 provided to Staff on April 25, 2006 in response to data request BNC 1.10. An
8 independent Certified Public Accountant that prepared the tax returns for all entities and
9 Mr. Jim Rhodes personally, confirmed in a letter that all required tax returns have been
10 filed for 2003, 2004 and 2005 and there are no outstanding tax obligations. It is insincere
11 of Staff and contrary to Commission past practice to now claim that Staff is "even more
12 concerned that any tax component provided for in the rates of the potential public service
13 companies is in fact a tax obligation of the ultimate taxpayer." A vast number of public
14 utilities in this state are subsidiaries of a holding company, in which consolidated tax
15 returns are prepared and paid at the parent level, yet the utility is still allowed a tax
16 component in the rates based on taxable income at the utility level. It is incredulous that
17 Staff would even consider not including a tax component because the shareholder is the
18 ultimate taxpayer.

19 Perkins provided a copy of Moody's Investor Services Rating Action for "The
20 Rhodes Companies, LLC" indicating the issuance of publicly held debt in the amount of
21 \$600 million dollars backed by assets in excess of \$1.6 billion as evidence of the financial
22 stability of Mr. Jim Rhodes. As is evidenced by Exhibit A of Staff's Notice of Errata filed
23 June 23, 2006, Mr. Jim Rhodes owns 100% of Sagebrush Enterprises, Inc. which in turn
24 owns 100% of Rhodes Companies, LLC. Staff's assertion that this information is not
25 relevant to determining the financial ability of the Applicants' owner is absurd at best and
26 flies in the face of its own reason for the motion to compel the tax returns of the affiliated
27 entities, including Rhodes Companies, LLC.

28

1 Furthermore, the possible alternative that Staff claims to have suggested is not an
2 alternative. It is not usual or customary for individuals to have personal audited financial
3 statements. People do not keep a set of books in accordance with Generally Accepted
4 Accounting Principles for their own personal finances. Financial ability or stability is
5 generally determined by financial net worth and not by income or expenses. Providing
6 the Moody's report is independent evidence of significant assets under the ownership and
7 control of Mr. Jim Rhodes.

8 Finally, the usual practice of this Commission is to request a performance bond
9 from the owner of the utility to guarantee the utility will have the necessary funds to
10 operate. Through verbal discussion with the Commission's Legal Division, the Applicants
11 indicated willingness to post a performance bond acceptable to the Commission. The
12 Applicants are still willing do so.

13 **II. TRANSFER OF OWNERSHIP OF UTILITY COMPANIES TO RHODES HOMES**
14 **ARIZONA, LLC NEGATES STAFF'S PURPORTED NEED FOR TAX RETURNS.**

15 As part of ongoing tax and estate planning, Mr. Jim Rhodes conveyed his shares of
16 Perkins to Rhodes Homes Arizona, LLC ("Rhodes Homes"). Rhodes Homes, a company
17 with over \$30 million in assets, is the owner of 100% of the shares of Perkins. Rhodes
18 Homes is willing to execute a corporate guarantee for the utility companies. As evidence
19 of its financial strength and ability, Rhodes Homes can provide Staff with financial
20 statements that demonstrate the financial strength of Rhodes Homes. Rhodes Homes is in
21 turn 100% owned by Rhodes Companies, LLC. As the independent Moody's report
22 provided to Staff states, Rhodes Companies LLC has assets in excess of \$1.6 billion.

23 Furthermore, as noted above, the Applicants are willing to post a performance bond
24 acceptable to the Commission to address Staff's concerns. By executing a corporate
25 guarantee and the posting of performance bonds by the utilities, there is no longer a need
26 for the tax return information beyond a fishing expedition.

1 **III. A PROTECTIVE ORDER IS REQUIRED TO PROTECT NON-PARTIES FROM**
2 **IMPROPER INTRUSION INTO CONFIDENTIAL TAX RETURN INFORMATION,**
3 **PROPRIETARY BUSINESS PLANS AND ESTATE PLANNING.**

4 Commission Staff's discovery requests have the potential to seriously and
5 irreparably harm the developer and all affiliates of the developer who are not parties to
6 this matter and have no involvement in this action. There is good cause to issue a
7 protective order to protect the non-parties from the "annoyance, embarrassment,
8 oppression, or undue burden or expense" that would arise from this disclosure. Ariz. R.
9 Civ. P. 26(c)(1).

10 Courts have long recognized that allowing opposing parties in litigation to obtain
11 information about nonparty customers would seriously impair a party's business and
12 "good will among its customers." *Wear-Guard Corp. v. Van Dyne-Crotty, Inc.*,
13 No. 90-1948, 1990 U.S. Dist. LEXIS 17039, at *10 (E.D. Pa. Dec. 13, 1990); *see also*
14 *Volkswagenwerk Aktiengesellschaft v. Westburg*, 260 F. Supp. 636, 637 (E.D. Pa. 1966)
15 (allowing plaintiffs to make inquiries of defendant's customers results in "obvious and
16 irreparable" prejudice). This holds true here, where Commission Staff is seeking to obtain
17 tax return information about all of Perkins' affiliates that have no involvement with this
18 case. To allow Commission Staff to obtain tax return and the related business relationship
19 information available in tax return filings, after Staff refused to guarantee nondisclosure to
20 the public, would be an invasion of Mr. Rhodes financial privacy harming his ability to
21 confidentially plan for business growth or to conduct estate planning, in addition to
22 exposing highly confidential financial information to competitors of the Rhodes entities.

23 In addition, there is a public policy against unnecessary public disclosure to
24 encourage taxpayers to file complete and accurate returns. *Federal Savings & Loan Ins.*
25 *Corp. v. Krueger*, 55 F.R.D. 512 (N.D. Ill. 1972). The courts have recognized that no
26 company, having a choice, would permit another company to go on a fishing expedition
27 through its records. *Premium Service Corp. v. The Sperry & Hutchinson Co.*, 511 F.2d
28 225, 229 (9th Cir. 1975). If a party has not met its burden of establishing a compelling
need or if there are less intrusive means by which the needed information can be obtained

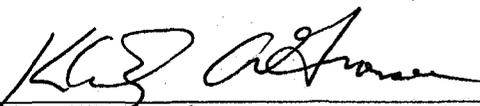
1 which have not been exhausted, then a motion to compel must be denied. *See generally,*
2 *Premium Service Corp.* Staff has failed to meet its burden of proof.

3
4 **IV. CONCLUSION.**

5 Commission Staff has failed to meet its burden in its request for the tax return
6 information. It neither demonstrated a compelling need for this information nor did it
7 exhaust all other less intrusive means by which the information can be obtained.
8 Moreover, the need for the tax return information is moot by virtue of the transfer of
9 ownership of Perkins to Rhodes Homes. Furthermore, allowing Commission Staff to
10 obtain tax return information about entities that are not parties to this case is likely to
11 seriously damage the affiliates, Mr. Rhodes and/or his family's ability to privately plan for
12 business growth or to privately conduct estate planning. Applicants respectfully request
13 oral argument on this issue.

14 DATED this 6th day of July, 2006.

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